STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Verizon North Inc. (f/k/a GTE North Incorporated) and Verizon South Inc. (f/k/a GTE South Incorporated)	**)**	
	)	**ICC Docket No. 00-0812**
Petition seeking approval of cost studies for Unbundled Network Elements, avoided costs and intrastate switched access services.	**)**	

SECOND SUPPLEMENTAL BRIEF OF
AT&T COMMUNICATIONS OF ILLINOIS, INC.

AT&T Communications of Illinois, Inc. ("AT&T") submits this Second Supplemental Brief pursuant to the Notice of Administrative Law Judge Ruling dated January 28, 2004 directing the parties to brief the following issue:

Has the FCC in its NPRM affirmed the commitment to UNE rates based upon the forward looking costs of providing such services as the incumbent's network is able to support?

For purposes of this brief, AT&T assumes that the Notice is intended to refer to the FCC's Notice of Proposed Rulemaking, *In the Matter of Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, FCC No. 03-224, WC Docket No. 03-173 (rel. September 15, 2003) ("NPRM").

First it must be recognized that the NPRM is intended to solicit comments on tentative conclusions and modifications to the FCC's current UNE pricing regime and is not an order that resolves the issues upon which comments are invited. Nevertheless, to answer the question posed for purposes of this Second Supplemental Brief, one need look only to Paragraph 4 of the

NPRM wherein the FCC stated that its tentative conclusions and modifications regarding UNE pricing "seek to preserve its forward-looking emphasis and its pro-competitive purposes, while at the same time making it more transparent and theoretically sound." Thus, the FCC's commitment to continue to use a methodology that sets prices on the basis of the forward-looking cost of providing UNEs remains intact. "Although some incumbent LECs continue to press for UNE rates based on an historical cost methodology, in this proceeding we reaffirm our commitment to forward-looking costing principles." NPRM ¶ 29.

The NPRM did raise the possibility that the FCC might decide to modify some of the assumptions used in the development of a forward-looking cost study to more closely account for the real-world attributes of the routing and topography of the incumbent's network, but reached no conclusion on how it would do so. *Id.* ¶ 52. Indeed, the ultimate question the FCC seeks to answer is not whether it should alter its commitment to forward-looking costing methodology but whether an alternative approach regarding the forward-looking network to be modeled "would produce results that are more consistent across states and send better entry and investment signals to incumbents and competitors." *Id.* ¶ 55. How that question is ultimately answered may affect some of the assumptions underlying the modeled network's design, but will not result in the FCC abandoning forward-looking costing principles.

In addition to the NPRM, the FCC's commitment to forward-looking costing methodology in pricing UNEs was also confirmed in its nearly contemporaneous Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338 (rel. Aug. 21, 2003) ("*Triennial Review Order*"). In that Order, the FCC expressly rejected suggestions that it make fundamental changes in the theory underlying TELRIC at this time.

Therefore, unless and until the FCC issues a new order following its review of the comments it receives in response to the NPRM, the applicable standard to be used by state commission's in pricing UNEs remains unchanged.

In the *Triennial Review Order* the FCC affirmed its view that prices in a competitive market tend towards incremental costs and that TELRIC, as the pricing standard for unbundled network elements that an incumbent must provide pursuant to Section 251 of the Telecommunications Act of 1996, is intended to replicate, to the extent possible, the price that the incumbent LEC would be able to charge in a competitive market. Accordingly, "TELRIC equates the current market value of the existing network of an incumbent telecommunications provider with the cost the incumbent LEC would incur today if it built a local network that could provide all the services its current network provides, to meet reasonably foreseeable demand, using the least-cost, most-efficient technology currently available." *Triennial Review Order* ¶ 669.

Second, while the FCC clarified two aspects of its TELRIC pricing standard, it expressly declined suggestions that it adopt any fundamental changes to the theory underlying TELRIC stating:

> In addition to clarification of our rules, some of the incumbent LECs have proposed fundamental changes to the theory underlying the TELRIC rules.2036 These proposals go well beyond the single pricing issue identified in the *Triennial Review NPRM* – whether to modify or clarify our rules to encourage investment in new facilities. We find that the record in this proceeding does not support the type of dramatic changes proposed by the incumbent LECs.2037 Rather, we find that issues related to modification of our TELRIC pricing framework are best addressed in a future proceeding dedicated to that topic. Accordingly, ***we will leave the general TELRIC framework intact at this time*** and consider the need for changes on a more complete record in a future review proceeding.
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> fn 2036. Verizon, for example, suggests we establish prices based on the costs of its actual network, rather than a hypothetical network. *See* Verizon July 18, 2002 TELRIC *Ex Parte* Letter at 4 ("[T]he Commission should alter its methodology to

> eliminate the assumption that the existing network is completely 'reconstructed' to reflect a technology mix that goes beyond what likely will ever be in place in any real-world network.").
>
> *Id.* ¶676 (emphasis supplied)

The FCC did take the opportunity to clarify how cost of capital and depreciation should be handled in a TELRIC analysis. First, a TELRIC-based cost of capital should reflect the risks of a competitive market. *Id.* ¶680. Second, to reflect its view that a TELRIC-based cost of capital should reflect any unique risks associated with new services that might be provided over certain types of facilities, the FCC approved the use of UNE-specific costs of capital as an acceptable method of reflecting any risk associated with new facilities that employ new technology and offer new services. *Id.* ¶683. As an example of what it meant by UNE-specific costs of capital in this context, the FCC suggested that a carrier in a TELRIC proceeding could attempt to demonstrate that the cost of capital associated with new services that might be provided over mixed copper/fiber loops is higher than the cost of capital used for voice services provided over other UNEs. *Id.* However, the FCC did not mandate state commissions to adopt multiple costs of capital. Rather, it concluded that states could adopt "a single cost of capital for all UNEs that appropriately reflects the risks associated with competitive markets for the services provided over incumbent LEC networks." *Id.* ¶ 684.

With respect to depreciation, the FCC clarified that state commissions continue to have discretion in determining the asset lives they use in calculating depreciation expense. *Id.* ¶ 688. However, it clarified that the rate of depreciation over the useful life should reflect the actual decline in value that would be anticipated in the competitive market TELRIC assumes. *Id.* ¶ 689.

In short, in the NPRM the FCC affirmed its commitment to the use of a forward-looking cost methodology for pricing UNEs and in the *Trienneial Review Order* the FCC clarified two aspects of TELRIC but made no fundamental change in its basic framework or underlying theory. Thus at the present time, TELRIC continues to assume that the value of an incumbent LEC's network is constrained by the most efficient technology available, even if the incumbent LEC itself does not deploy, or plan to deploy, that technology. *Id.* ¶ 672.

Conclusion

The FCC has affirmed that prices for network elements that must be unbundled under Section 251 are and will continue to be based on forward looking costs. Furthermore, while some of the assumptions underlying the network may ultimately be modified, at the present time UNE prices must be based upon the costs the incumbent LEC would incur today if it built a local network that could provide all the services its current network provides, to meet reasonably foreseeable demand, using the least-cost, most-efficient technology currently available.

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Respectfully submitted,

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By: ________________________________

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